

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Campbell Analyst: Marion Mann DeJong Bill Number: AB 1276
Related Bills: See Legislative History Telephone: 845-6979 Introduced Date: 03/23/2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Manufacturers' Investment Credit/Extend to Certain Electric Power Production

SUMMARY

This bill would extend the Manufacturers' Investment Credit (MIC) to certain electric power generation businesses.

PURPOSE OF THE BILL

The purpose of this bill appears to be to encourage investment in property that generates electricity using alternative energy sources.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2001.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are needed to define "generation of electricity." Department staff is available to assist the author with amendments.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's trade or business. Also, these laws allow a depreciation deduction for the obsolescence or wear and tear of property used in a trade business or held for the production of income.

Existing federal law does not have a credit comparable to the MIC. However, federal law does provide an investment property credit for certain depreciable or amortizable property that qualifies for the rehabilitation, energy, or reforestation credit.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

03/19/01

The energy credit is 10% of the basis of each energy property placed in service during the tax year. "Energy property" is:

- Equipment that uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat; or
- Equipment used to produce, distribute, or otherwise utilize energy from a geothermal deposit. In the case of electricity generated by geothermal power, only equipment used up to but not including the electrical transmission stage is "energy property."

Existing federal law also provides a renewable electricity production credit. For 2000, the credit is 1.5 cents per kilowatt hour of electricity produced at a "qualifying facility" by taxpayers from wind, "closed-loop biomass," (generally, organic plants, except timber, grown for the sole purpose of being used to generate electricity), or poultry waste. The electricity must be sold to an unrelated person during the taxable year. The credit is available for a ten-year period beginning the year the facility is placed in service.

Existing state law allows qualified taxpayers a credit, known as the MIC, equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in California.

For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing activities described in specified codes listed in the Standard Industrial Classification (SIC) Manual, 1987 edition. Qualified property is any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code (IRC) and used primarily for:

- manufacturing, processing, refining, fabricating, or recycling of property;
- research and development;
- the maintenance, repair, measurement, or testing of otherwise qualified property; or
- pollution control that meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) For certain taxpayers engaged in specified SIC Code activities, special purpose buildings and foundations.

For taxpayers engaged in computer programming and computer software related activities, qualified property includes computers and computer peripheral equipment used primarily for the development and manufacture of prepackaged software, and the value of any capitalized labor costs directly allocable to such property.

The MIC explicitly excludes certain types of property from the definition of qualified property, such as furniture, inventory, and equipment used in an extraction process.

THIS BILL

This bill would add taxpayers engaged in electric service activities to the definition of “qualified taxpayer” under the MIC provisions. The electric service activities are described in SIC Code 4911 as establishments engaged in the generation, transmission, and/or distribution of electric energy for sale. Taxpayers holding a Certificate of Public Convenience and Necessity issued by the California Public Utilities Commission would not be qualified taxpayers for purposes of the MIC.

This bill would modify the definition of “qualified property” to include tangible personal property (IRC Section 1245(a) property) used by a qualified taxpayer in electric service activities primarily for “generation of electricity.”

This bill also would make minor technical changes to delete obsolete language referencing the low-emission vehicle credit, specify specific statutes that amended the MIC, and change “which” to “that” in various places.

IMPLEMENTATION CONSIDERATIONS

The term “generation of electricity” is not defined. Undefined terms can result in disputes between taxpayers and the department.

LEGISLATIVE HISTORY

AB 2461, Runner (1999/2000) would have (1) increased the MIC from 6% to 7% of the cost of certain property used in manufacturing, (2) extended the credit to certain electric power generation or mineral extraction businesses, and (3) extended the credit indefinitely. *AB 2461* was held in the Assembly Revenue and Taxation Committee. *AB 2596, Corbett (1999/2000)* would have extended the MIC to taxpayers engaged in the generation of electricity using natural gas. *AB 2596* was held in the Assembly Appropriations Committee. *SB 1920, Kelley (1999/2000)* would have extended the MIC to certain electric power generation corporations. *SB 1920* was held in the Senate Revenue and Taxation Committee.

AB 45X, Kelley (2001/2002) would extend the MIC to taxpayers engaged in certain electric power generation activities. *AB 45X* is in the Assembly Appropriations Committee. *AB 240, Runner (2001/2002)* is identical to *AB 2461 (1999/2000)*. *AB 96X, Campbell (2001/2002)* is identical to this bill.

OTHER STATES' INFORMATION

Review of *Illinois, Massachusetts, Michigan, and New York* tax laws found no comparable tax credit for investments in property used to generate electricity like that proposed by this bill. The laws of these states were reviewed because they have credits comparable to the MIC.

FISCAL IMPACT

If the implementation consideration addressed in this analysis is resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Extending the MIC to certain electric power production would result in the following revenue losses:

Revenue Impact of AB 1276 For Taxable Years Beginning On Or After January 1, 2001 Assumed Enactment After June 30, 2001 (In Millions)		
2001-02	2002-03	2003-04
-\$9	-\$11	-\$12

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

This estimate is based on data from a U.S. Census Bureau survey of capital expenditures by relevant industries for 1998 and microsimulation model of California tax returns for tax years 1997 and 1998. These numbers were grown to approximate 2001 and beyond. The credit use rates taken from the models were then applied to derive the aggregate credit use. The fiscal year cash flow patterns are based on the department's analysis of how manufacturers adjusted their tax payments to reflect the reduction in liability resulting from the current law MIC.

This estimate does not include losses resulting from qualified taxpayers as defined under current law that might receive additional credits for activities that would qualify under the changes made by this bill. Such losses cannot be quantified since the data and information needed are not available.

ARGUMENTS/POLICY CONCERNS

This bill would benefit transactions for which binding contracts already exist and would not be limited to benefit only future business decisions. Under this bill, any costs paid under the terms of a contract entered into after January 1, 1994, but prior to taxable years beginning on or after January 1, 2001, would qualify for the credit.

This bill would expand the activity test for qualified property to include the generation of electricity. As a result, taxpayers that qualify for the MIC under existing law could claim the MIC for existing auxiliary activities. For example, a manufacturing plant that includes on its premises a co-generation facility that produces electricity to run the manufacturing line would qualify for the MIC under the revised activity test. Under current law, while this co-generation facility may be assigned the same SIC Code as the manufacturing activity it supports, the costs of the property in the co-generation facility would not qualify for the MIC since the property is not used in a qualified activity.

LEGISLATIVE STAFF CONTACT

Marion Mann DeJong
Franchise Tax Board
845-6979

Brian Putler
Franchise Tax Board
845-6333